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C O N F I D E N T I A L SECTION 01 OF 03 SHANGHAI 000026

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SUBJECT: TAIWAN BANK KEEN TO START BUSINESS IN MAINLAND

REF: A) 07 SHANGHAI 102; B) 07 SHANGHAI 621; C) 08 SHANGHAI 526

CLASSIFIED BY: Simon Schuchat, Deputy Principal Officer, U.S.
Consulate, Shanghai, U.S. Department of State.

REASON: 1.4 (b), (d)

¶1. (C) Summary: The chief representative of a Taiwan bank in the Mainland expects SEF and ARATS to sign a financial MOU in March 2009, which would allow his bank to begin operations in the Mainland by the end of 2009. Lack of RMB/NTD convertibility and restrictions on RMB lending cast a shadow over business prospects, but the banker is hopeful cultural ties and a common business mindset will lure Taiwan firms in the Mainland to Taiwan banks. Seven Taiwan banks currently have rep offices in the Mainland and plan to expand to cities with large Taiwan business communities after the MOU is signed, he said. Mainland banks are also eager to expand to Taiwan, raising concerns in Taiwan that the larger Mainland banks will take business away from their much smaller Taiwan rivals. The banker's main concern, however, is establishing an internal control mechanism unique to the Mainland. Local governments in the Mainland have been supportive and eager to host Taiwan banks. End summary.

Finally, After 6 Years

¶2. (C) Econoff spoke in January 2009 with Peter WT Chang, Chief Representative of Chang Hwa Bank's Mainland operations. Chang Hwa is a Taiwan bank with its Mainland rep office in Kunshan, Jiangsu Province, a city with 3000 Taiwan enterprises (See Refs A, B, C for more on Kunshan and Chang Hwa Bank). Chang Hwa's rep office was first set up in the Mainland in 2002, but its conversion into a branch office was impeded by cross-Strait political tension during former Taiwan President Chen Shui-bian's tenure. Peter Chang himself arrived in the Mainland in 2007, taking over from the previous chief representative, and has been conducting "market investigations" and building local contacts the past 2 years. Now, after years of waiting, Chang is optimistic that a financial MOU will be signed by SEF and ARATS in March 2009, paving the way for Taiwan banks, like his, to commence business in the Mainland.

Timeline: End of 2009, At the Earliest

¶3. (C) Chang said that, even after the MOU is signed, Taiwan

banks will not be able to start business in the Mainland immediately. He said that current plans call for a 6-month "application period" (during which the Chinese Government will review the bank's application) and a 6-month "organization period" (during which the bank will set up its office, connect its IT infrastructure, and be subject to government inspection).

Chang hopes that the "application period" will be cut by several months through negotiation at the SEF-ARATS talks, allowing his bank to commence operations "by the end of 2009, at the earliest."

Some Tough Issues Ahead

¶ 14. (C) Chang cited some difficult issues to be worked out at the SEF-ARATS talk. One is the aforementioned lengthy application process. Another is the restriction on RMB lending by foreign and Taiwan banks. Under current rules, according to Chang, foreign and Taiwan banks have to operate in the Mainland for 3 years - 2 of which have to be profitable - in order for the bank to obtain a license to lend in RMB. Even with current restrictions on RMB lending, Taiwan banks can still offer services to Taiwan firms using USD, since most Taiwan companies in the Mainland export to the United States and require letters of credit in USD, said Chang. He expects RMB lending rules will be relaxed, since China is already past its 5 year grace period following WTO accession and will come under greater pressure to open its banking sector to outside banks.

¶ 15. (C) The lack of RMB/NTD (New Taiwan Dollar) convertibility was another challenge cited by Chang. Chang thinks this issue will be the most difficult to resolve because of political implications for both sides. Some in Taiwan fear full convertibility and the "free flow" of RMB in Taiwan will imply

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that Taiwan is part of China. The Chinese Government is concerned about possible capital outflows. Although the issue may be raised at the SEF-ARATS meeting, Chang does not believe this will be resolved anytime soon.

Taiwan and Mainland Banks Looking to Expand

¶ 16. (C) Despite these challenges, Chang thinks Taiwan banks are eager to expand in the Mainland and set up branches in cities with large Taiwan business communities, such as Hangzhou and Qingdao. Taiwan firms are also keen to do business with Taiwan banks, he said, because of their "common business language" based on cultural ties and emphasis on building trust. Currently, Taiwan firms that borrow from Mainland banks must pay back their loans every year, regardless of their business condition, and the banks conduct new (and opaque) annual reviews before deciding whether or not to renew the loans. This often leaves Taiwan firms in a state of limbo. Chang thinks Taiwan firms and Taiwan banks can have relationships based on trust, in which there will be an implicit understanding that loans will be renewed automatically as long as the firms' business remains stable. Taiwan firms would thus feel "more comfortable" dealing with Taiwan banks, said Chang.

¶ 17. (C) According to Chang, 7 Taiwan banks currently have rep offices in the Mainland - Chang Hwa Bank, Landbank, First Bank, China Trust Bank, Huanan Bank, Taiwan Corporate Bank, and Cathay Bank. Three more Taiwan banks with over USD 10 billion in assets (the minimum required under Mainland rules according to Chang) are planning to open up branches in the Mainland, said Chang. He thinks Mainland banks are also eager to expand to Taiwan. Many already have Taiwan business clients, and establishing an office in Taiwan would allow these banks to understand their clients' situation better, said Chang.

Concerns about Competition, Internal Controls

¶ 18. (C) Some banks in Taiwan are concerned that, if Mainland banks open up offices in Taiwan, some Taiwan customers may switch to their much larger Mainland rivals who may be able to offer bigger loans at cheaper rates, according to Chang. He

said average profit margins for Taiwan banks (2 to 3 percent) are already well below that of Mainland banks. With increased competition on the island, some Taiwan banks are concerned that margins will become even lower.

¶9. (C) The biggest concern for Chang, however, is establishing an effective internal control mechanism unique to the Mainland. He said even in Taiwan and Hong Kong, which already have well-established internal control systems in place, there are cases of employees siphoning off large chunks of money. He mentioned that several employees of a Taiwan bank in Hong Kong recently made off with HKD 50 million. Chang admitted he does not fully understand China's regulatory system. He is concerned that, if a corrupt local employee makes off with the bank's money and disappears somewhere in the interior provinces, there will be no way to track down this individual and obtain local government assistance.

Impact of Politics

¶10. (C) Although political tension in cross-Strait relations would be bad for the overall business environment, Chang does not think renewed tension in the future would turn back the clock on recent progress in the economic/financial front. However, he speculated that the Chinese Government may be reluctant to resolve some of the more difficult issues, like currency convertibility, based on concerns that Ma Ying-jeou (and the KMT) may not be in power beyond 2012.

Local Government Support

¶11. (C) Chang said the local government in Kunshan has been very supportive of his bank. When rumors spread that First Bank, a Taiwan bank, would move its Mainland office from Beijing to Suzhou after the MOU since Suzhou has a larger Taiwan business community than Beijing, the Kunshan government called Chang "many times" to confirm that Chang's bank would not

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similarly move from Kunshan to another location. According to Chang, local governments want to keep Taiwan firms because they create many jobs, and they understand that Taiwan firms want to do business with Taiwan banks. Some cities with large Taiwan business communities, like Suzhou, Hangzhou, and Qingdao, will thus create incentives, such as tax breaks, for Taiwan banks to open branches in their cities, said Chang.

Comment

¶12. (C) Despite Chang's overall optimism, it is far from certain that the road ahead will be smooth for Taiwan banks in the Mainland. Chang did not fully address how the lack of RMB/NTD convertibility and restrictions on RMB lending would affect his business. However, based on our other conversations with Taiwan businesspeople in the Mainland, Taiwan firms seem eager to do business with Taiwan banks, citing the annual review by Mainland lenders as a source of frustration. (Note: Several Taiwan businessmen in Kunshan mentioned that, of all the agreements from recent cross-Strait talks, the relaxation of restrictions on Taiwan banks would have the biggest direct benefit for their operations. See Ref C. End note.) However, it remains to be seen how quickly Taiwan banks in East China will be allowed to lend in RMB and how this will affect their business relationship with Taiwan firms in the area, particularly as Taiwan firms cope with the current economic downturn.

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